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SUBJECT: PRT NINEWA: CREDIT CRUNCH STIFLES ECONOMIC DEVELOPMENT

¶1. This is a Nineva Provincial Reconstruction Team (PRT) message.

¶2. SUMMARY: Banking leaders in Nineva province told PRT that significant barriers to commercial and consumer lending in Nineva province continue to hamper economic development. The precarious security situation, a paralyzed property deed registration system, and the lending requirements of the Central Bank of Iraq are all serious impediments to the effective flow of capital, and the consensus among these experienced bankers is that the only near-term growth in the financial services industry in Nineva will be in private banking. New PRT-led efforts to capitalize small, credit union-style financial institutions linked to agricultural associations or women's groups will fill a critical void among existing groups who have a shared economic interest in working together and are therefore more risk tolerant. END SUMMARY.

RISK TO LIFE AND LOAN

¶2. At a bankers roundtable PRT Nineva organized on February 4, bank managers from Nineva branches of the Rafidain, al-Warka, and Agriculture Banks, as well as the Central Bank of Iraq commented that they worked in fear of their own success. The bankers told PRToffs that a growth in deposits, increased lending, improved technology, and new, successful banking ideas could make them targets of criminal activity. This fear serves as a chill on expansion of the financial sector in the region, as there is limited incentive to grow the profitability of the banking institution. In addition to their vulnerability to criminal activity, the bankers also told PRToffs that current security measures impede their commercial activities. The representative from Rafidain Bank, for example, complained that physical barriers erected throughout the city of Mosul stifle trade activity by limiting physical movement. He felt that the current security and work environment had improved somewhat, but that the barriers are excessive.

THE PROBLEM OF COLLATERAL

¶3. The bankers reported that Provincial Governor Atheel al-Nujaifi's (al-Hadba) sudden and temporary of a land deed registration office on the east side of Mosul caused lending in much of the city to grind nearly to a halt, since most lenders accept only land deeds as satisfactory collateral. The registration office in western Mosul remains open, however the numerous barriers and checkpoints around the city make travel to this office difficult. (NOTE: Governor al-Nujaifi claims he closed the office due to money laundering, theft, and other criminal activity in the land registration offices. END NOTE). The Central Bank of Iraq's rather short list of acceptable forms of collateral, which includes real estate deeds or the signature guarantee of a

GOI employee, reinforces the risk-averse mindset and serves as a further limitation on lending.

An Agricultural Bank representative did report success with a recent zero percent interest loan program in rural areas in the province, but noted that the program served only approximately 20 percent of prospective borrowers who qualified. The bankers agreed the primary reason for the success of this program was that the lending took place in secure areas of the province.

PRIVATE FINANCIAL SECTOR STIRS

14. While branches of state-owned banks await instructions from Baghdad to implement reforms and innovations, private banks are beginning to act with increased independence. Al Qbanks are beginning to act with increased independence. Al Warka Investment Bank reports active and expanding Electronic Funds Transfer systems, although these still represent less than ten percent of total transactions. Al Warka's representative also told us that it now has three functioning Automatic Teller Machines operating in the province. Many leading bankers expressed interest in implementing new technologies, which could boost their lending capacity and tolerance for risk, although the bulk of their current lending portfolios consists of larger high-interest loans (ranging from 17 to 22 percent) and not small, low-interest loans to fund small business development.

COMMENT

15. Microfinance activity in Ninewa illustrates signs of

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continued growth and bank savings rates increase nationwide, but the barriers the bankers reported to us hamper an industry that otherwise should be in high growth mode. When the public either stores its savings under their mattresses or deposits its savings in banks that store the capital under their mattresses, such risk aversion in lending stifles job creation and wealth building. In Ninewa, such barriers must be addressed before there can be sustained capital flow and economic growth impacting the diverse communities facing abject poverty in the province. Increased independence from banking regulations initiated in Baghdad may cause Ninewa's banks to be more aggressive and innovative in overcoming these barriers to feed small entrepreneurs with capital. Depending on the degree to which such liberalization occurs, U.S. efforts to stimulate economic growth through banking more likely will find traction within the private banking space, even though an extraordinarily large percentage of Iraqi capital flows through state-owned banks. One key node for this expansion is a nascent PRT effort to capitalize small business development centers that link lending risk to the established tradition of cooperation and shared economic interest that thrives within agricultural associations, women's groups, and other trade groups across the province

(septel) END COMMENT.

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